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## Business Law

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## BUSINESS LAW

### I. CORPORATE LAW

#### A. Disregard of Corporate Form

In the case of *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*,<sup>1</sup> the Fourth Circuit reaffirmed that South Carolina law will allow the corporate form to be disregarded in certain circumstances.<sup>2</sup> Although the doctrine of “piercing the corporate veil” has long been recognized in South Carolina,<sup>3</sup> the court in *DeWitt* has thoroughly analyzed the current law on the issue and has taken a liberal view of the South Carolina position.

W. Ray Flemming owned approximately ninety percent of the stock of Flemming Fruit Company.<sup>4</sup> Flemming Fruit acted as a selling agent for fruit growers. The corporation sold the produce in wholesale markets and used the services of the plaintiff-appellee, DeWitt, to transport the produce to the purchaser. The grower received the full purchase price, less Flemming’s sales commission and the transportation costs, which were represented as having been remitted to the plaintiff. However, during the period involved in this case, DeWitt was not paid. Flemming Fruit Company was in fact insolvent. As a result, DeWitt brought an action to pierce the corporate veil and hold Flemming, the president of the corporation, personally liable for the debt. The district court pierced the corporate veil and found Flemming liable;<sup>5</sup> Flemming appealed.

Since the facts involved in any given case on piercing the corporate veil will likely be unique,<sup>6</sup> the findings of the trial court will be considered “presumptively correct and [will] be left undisturbed on appeal unless . . . clearly erroneous.”<sup>7</sup> After consid-

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1. 540 F.2d 681 (4th Cir. 1976).

2. While a corporation is usually considered as an entity distinct from its shareholders, a court can disregard the corporate form and hold the individual shareholders liable for acts “knowingly and intentionally done in the name of the corporation.” 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.1 (rev. perm. ed. 1974).

3. *Long v. McGlon*, 263 F. Supp. 96 (D.S.C. 1967); *Parker Peanut Co. v. Felder*, 200 S.C. 203, 20 S.E.2d 716 (1942); *Nettles v. Sottile*, 184 S.C. 1, 191 S.E. 796 (1937).

4. This was according to Flemming’s own testimony, although it was not verified by any stock records.

5. *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, No. 74-1166 (D.S.C., filed April 4, 1975).

6. *Auer v. Frank*, 227 Cal. App. 2d 396, 38 Cal. Rptr. 684 (1964).

7. 540 F.2d at 684 (quoting *G. M. Leasing Corp. v. United States*, 514 F.2d 935, 939 (10th Cir.), *aff’d in part and rev’d in part on other grounds*, 97 S.Ct. 619 (1977)).

ering the facts involved in *DeWitt*, the Fourth Circuit concluded that the finding of the district court was not clearly erroneous and affirmed.<sup>8</sup> The court relied on two apparently distinct considerations to reach this conclusion.

First, the court used the "alter ego" or "instrumentality" theory for piercing the corporate veil. The court began by recognizing that while a corporation is usually treated as an entity distinct from its stockholders,<sup>9</sup> this results from a legal fiction that will be disregarded when necessary to prevent injustice.<sup>10</sup> The result is that the debts of the corporation are treated as the individual debts of its stockholders. Because this can clearly have far-reaching effects, the power to pierce the corporate veil should only be used "reluctantly" and "cautiously."<sup>11</sup> The defendant had contended that the corporate form should be disregarded only when there is "proof of plain fraud."<sup>12</sup> However, the court stressed that while fraud is the most common basis for disregarding corporateness, the general rule is that fraud is not a necessary element,<sup>13</sup> and South Carolina law is in accord with this general rule.<sup>14</sup> But it is "equally as well settled . . . that the mere fact that all or almost all of the corporate stock is owned by one individual or a few individuals, will not afford sufficient grounds for disregarding corporateness."<sup>15</sup> It is a well-recognized and legitimate objective to incorporate in order to avoid individual liability. Nonetheless, when such ownership is found along with certain other factors, the courts will pierce the corporate veil and impose individual liability.<sup>16</sup> These factors, as enumerated by the court, are undercapitalization for the purposes of the corporate undertaking, failure to observe corporate formalities, nonpayment of dividends, the insolvency of the debtor corporation, siphoning of funds of the corporation by the dominant stockholder, nonfunc-

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8. 540 F.2d at 687.

9. See *Fishman v. State*, 128 Ga. App. 505, 513, 197 S.E.2d 467, 473 (1973).

10. *United States v. Milwaukee Refrigerator Transit Co.*, 142 F.2d 247 (E.D. Wis. 1905); *Stone v. Eacho*, 127 F.2d 284, 288-89 (4th Cir.), cert. denied, 317 U.S. 635 (1942).

11. 540 F.2d at 683.

12. *Id.* at 684.

13. *Anderson v. Abbott*, 321 U.S. 349, 362, reh. denied, 321 U.S. 804 (1944); *National Marine Serv., Inc. v. C.J. Thibodeaux & Co.*, 501 F.2d 940, 942 (5th Cir. 1974).

14. *Long v. Carolina Baking Co., Inc.*, 190 S.C. 367, 377, 3 S.E.2d 46, 50 (1939); *Jennings v. Automobile Sales Co.*, 107 S.C. 514, 516, 93 S.E. 188, 189 (1917).

15. 540 F.2d at 685.

16. *Id.* (citing with approval *Iron City Sand & Gravel Div. of McDonough Co. v. West Fork Towing Corp.*, 298 F. Supp. 1091, 1098 (N.D.W. Va. 1969), rev'd on other grounds, 440 F.2d 958 (4th Cir. 1971)).

tioning of other officers or directors, absence of corporate records, and the use of the corporation as a mere facade for the operations of the dominant stockholder or stockholders.<sup>17</sup> The decision to pierce the corporate veil must rest on a combination of these factors and the additional element of fundamental unfairness.<sup>18</sup>

The court found in *DeWitt* many of the above elements as well as the required injustice. Flemming had disregarded many of the normal corporate formalities. There were no adequate records showing who the other stockholders, officers or directors were. Although Flemming testified that there was one other director, Ed Bernstein, no real directors' meetings had ever been held,<sup>19</sup> and, more importantly, Bernstein had received no compensation from the corporation. There had been no stockholders' meetings.<sup>20</sup> But the factor that probably influenced the court most heavily was "the purely personal matter in which the corporation was operated."<sup>21</sup> Flemming made all of the decisions and was the only shareholder or officer to receive any compensation at all from the corporation. His salary, which was never authorized by the board of directors, "varied with what could be taken out of the corporation at the moment";<sup>22</sup> it ranged from \$15,000 to \$25,000 each year when the corporation showed no profit and had no working capital.

The court was greatly influenced by the fact that the corporation was undercapitalized:

If a corporation is organized and carries on business without substantial capital in such a way that the corporation is likely to have no sufficient assets available to meet its debts, it is inequitable that shareholders should set up such a flimsy organization to escape personal liability. The attempt to do business without providing any basis of financial responsibility to creditors is an abuse of the separate entity and will be ineffective to exempt the shareholders from corporate debts. It is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capi-

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17. 540 F.2d at 681.

18. *Id.* at 687.

19. Flemming testified that he and Bernstein, a New York resident, kept in contact by telephone.

20. In his original deposition, Flemming said there had been no shareholder meetings. Later, claiming that he had misunderstood the question, he produced minutes of five meetings. The trial judge found this evidence unconvincing. 540 F.2d at 688.

21. *Id.*

22. *Id.*

tal reasonably adequate for its prospective liabilities. If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege.<sup>23</sup>

The corporation initially had capitalization of five thousand shares issued for one dollar each. Two thousand shares had since been retired, and even the remaining three thousand dollars, "it seems fair to conclude, had been seemingly exhausted by a long succession of years when the corporation operated at no profit."<sup>24</sup> No dividends were ever paid, and the only working capital available to the corporation came from its commissions and the transportation charges which were not remitted to the plaintiff. The court also found in the undercapitalization the required element of injustice:

Were the opinion of the District Court herein to be reversed, Flemming would be permitted to retain substantial sums from the operations of the corporation without having any real capital in the undertaking, risking nothing of his own and using as operating capital what he had collected as due the plaintiff. Certainly, equity and fundamental justice support individual liability of Flemming for plaintiff's charges. . . . This case patently presents a blending of the very factors which courts have regarded as justifying a disregard of the corporate entity in furtherance of basic and fundamental fairness.<sup>25</sup>

If the decision to pierce the corporate veil had rested on these factors alone, there would be several serious shortcomings in the logic of the court. The manner in which Flemming operated the company is in reality very common in close corporations. All statutory formalities, except those mentioned by the court, were followed. For example, an annual report was filed with the South Carolina Secretary of State.<sup>26</sup> The statutory requirement for initial capitalization, one thousand dollars, had been met.<sup>27</sup> Moreover, there is authority for the proposition that undercapitalization should not be considered when a contract rather than a tort is

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23. H. BALLANTINE, BALLANTINE ON CORPORATIONS 302-03 (rev. ed. 1946).

24. 540 F.2d at 688.

25. *Id.* at 689.

26. *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, No. 74-1166 (D.S.C., filed April 4, 1975).

27. S.C. CODE ANN. § 33-7-60 (1976).

involved.<sup>28</sup> A person entering a contract has a duty of inquiry as to the financial basis of the corporation. Failure to make adequate inquiry can estop the injured party in a contract case from attempting to pierce the corporate veil, since he is assumed to contract on the financial basis of the corporation, not on the credit of the stockholders.<sup>29</sup>

However, there was an additional element in *DeWitt* which negates the estoppel arguments. Flemming had personally guaranteed payment of the debt to DeWitt. The Statute of Frauds did not bar enforcement of the oral promise.

[R]eliance on such statute is often regarded as without merit in a case where the promise or assurance is given "at the time or before the debt is created," for in that case the promise is original and without the statute . . . . A number of courts, including South Carolina, however, have gone further and have held that, where the promisor owns substantially all of the stock of the corporation and seeks by his promise to serve his pecuniary advantage, the question whether such promise is "within the statute of frauds" is a fact question to be resolved by the trial court and this is true whether the promise was made before the debt was incurred or during the time it was being incurred.<sup>30</sup>

The court treated the personal guarantee as an additional, though extremely important,<sup>31</sup> element in the overall pattern required to disregard the corporate form. However, a personal guarantee, not barred by the Statute of Frauds, would seem to be sufficient grounds to impose liability on Flemming without resort to the doctrine of piercing the corporate veil. Thus logically the court established two alternative bases for affirming the decision of the lower court: the "instrumentality" theory for piercing the corporate veil and the personal guarantee of Flemming. Because the instrumentality theory is weak without the added element of the guarantee, the major precedential value of this case is based on the personal guarantee of Flemming.

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28. Comment, *Disregard of the Corporate Entity: Contract Claims*, 28 OHIO STATE L.J. 441 (1967).

29. *Cranson v. I.B.M.*, 234 Md. 477, 200 A.2d 33 (1964).

30. 540 F.2d at 689 (citing *Davis v. Patrick*, 141 U.S. 479, 488-89 (1891); *American Wholesale Corp. v. Mauldin*, 128 S.C. 241, 244-45, 122 S.E. 576 (1924)).

31. 540 F.2d at 687. The court indicated that such a guarantee was an individually sufficient basis for piercing the corporate veil.

### B. *Shareholder Derivative Actions*

In *Grant v. Gosnell*,<sup>32</sup> the South Carolina Supreme Court considered what demands a shareholder must make before he can bring a derivative action. Generally, corporate management has the right to sue for injuries to the corporation.<sup>33</sup> Before a shareholder can bring a derivative action on behalf of the corporation, he must allege in his complaint and establish either that he has made a demand that the officers or directors bring the suit or that such a demand would be futile.<sup>34</sup> Many states now have a derivative action statute that incorporates this common law rule.<sup>35</sup> South Carolina does not have a derivative action statute but does follow the common law.<sup>36</sup>

In *Grant*, the plaintiff brought a derivative action on behalf of First State National Bank against several defendants allegedly involved in a series of fraudulent loans. The defendants included five former directors of the bank, two bank executives, and one bank customer. The complaint justified the failure to make a demand for relief on the directors and shareholders in the following way:

(2) Plaintiff has not made a demand on FSNB's directors and shareholders in an effort to have them institute this action directly rather than derivatively on FSNB's behalf, such failure to make such demands being excusable on the ground that FSNB's board of directors is controlled by, and a majority of its shares are held by, persons charged in this lawsuit with the wrongdoing that is the basis for this Complaint, all of which means that demands by the plaintiff on the board of directors and shareholders would be fruitless and utterly without productive consequences.<sup>37</sup>

Two of the defendants objected to the jurisdiction of the court because the plaintiff's allegation that a request for relief

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32. 266 S.C. 372, 223 S.E.2d 413 (1976).

33. 13 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5963 (rev. perm. ed. 1970).

34. *Id.* (citing *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936); *Hawes v. Oakland*, 104 U.S. 450 (1882)).

35. DEL. CH. CT. R. 23.1 (1974); MICH. COMP. LAWS ANN. § 450.1491 (1973); N.Y. BUS. CORP. LAW § 626 (McKinney) (1963).

36. *Thompson v. Thompson*, 214 S.C. 61, 51 S.E.2d 169 (1948); *Equitable Trust Co. of Columbia v. Columbia Nat'l Bank*, 145 S.C. 91, 142 S.E. 811 (1928); *Latimer v. Richmond & D.R.R.*, 39 S.C. 44, 17 S.E. 258 (1893).

37. Record at 2.

would be unavailing was "not founded upon fact or reason."<sup>38</sup> The lower court found that such a request "would have been an exercise in futility, and, therefore, such demand was unnecessary."<sup>39</sup> The defendants appealed, and the South Carolina Supreme Court affirmed.<sup>40</sup>

The factual situation involved in the case presented the court with two clear alternatives. The majority of the board of directors was never accused of wrongdoing. When the suit was filed, all but one of the directors who were defendants in the suit had resigned. Therefore, the court could have found that since a majority of the board was disinterested, a demand for relief should have been made. The lower court had chosen instead to look at the realities of the situation. Three of the defendants had maintained close ties with the bank. One, who had organized the bank, remained as chairman of the board, chief executive officer, and majority shareholder. A second defendant was attorney for the bank and resumed his position as director after the suit was filed. A third defendant, who was a past president and director, served as consultant to the bank. The lower court found, in effect, that these three controlled the board even though they did not represent a majority of it.<sup>41</sup>

The defendants had relied strongly on the Pennsylvania case of *Law v. Fuller*<sup>42</sup> to support their position that control of a majority of the stock by a defendant was not sufficient reason to excuse the required demand for intra-corporate relief.<sup>43</sup> Moreover, the defendants argued that the court should not have assumed that the remaining directors would not have exercised independent judgment; "the Court should have presumed that the directors would have performed their duty rather than that they would not."<sup>44</sup>

The lower court was unconvinced:

However, this Court is not persuaded by the logic of the Court in *Law*. *Law* ignores the reality that most director meetings of

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38. *Id.* at 8.

39. *Id.* at 22.

40. 266 S.C. at 377, 223 S.E.2d at 415.

41. Record at 22.

42. 217 Pa. 439, 66 A. 754 (1907).

43. Brief for Appellant at 7-8.

44. *Id.* at 9. South Carolina law imposes a duty on directors to act "in good faith with a view to the interests of the corporation and of the shareholders and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." S.C. CODE ANN. § 33-13-150 (1976).



relatively small corporations are controlled by directors who are also involved in the day-to-day activities of the Bank. Pharmacists, farmers and unkindred businessmen possess only lay knowledge of Bank operations. While recent reversals in the banking business point to a need for active diligence on the part of lay directors, this Court will not shut its eyes to reality.<sup>45</sup>

The supreme court found further support for the lower court decision in *Stahn v. Catawba Mills*,<sup>46</sup> where the court had excused the shareholder's failure to demand that corporate management bring the suit. The defendants argued against the applicability of *Stahn*, because that case involved a board where a majority of the members were defendants. The court, however, did not interpret *Stahn* to require that a majority of the board be alleged wrongdoers. The two elements that were emphasized in *Stahn*, the control of a majority of the stock by an alleged wrongdoer and the breach of trust involved, were both found in *Grant* and these factors were deemed controlling. Thus the supreme court affirmed the decision of the lower court and refused to dismiss the action for lack of jurisdiction.

## II. LABOR LAW

In *Hardee v. North Carolina Allstate Services, Inc.*,<sup>47</sup> the Fourth Circuit was confronted with two commonly recurring problems in the field of labor law. The first issue concerned the "arbitral bar," or the restriction on judicial action in a dispute covered by a collective bargaining agreement after an arbitrator has reached a final decision under the grievance and arbitration provisions of the contract. The second, and related, issue involved the union's duty of fair representation owed to all employees within the bargaining unit.

The defendant Allstate hired truckdrivers and leased them to various corporations. The drivers were paid by Allstate but dispatched by the companies for which they worked. The plaintiff Hardee was employed by Allstate and worked for Allied Chemical Motor Operations. Allied had scheduled Hardee for a trip that would have made it impossible for him to attend an important union meeting.<sup>48</sup> Hardee attempted to reschedule both the trip

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45. Record at 21-22.

46. 53 S.C. 519, 31 S.E. 498 (1898).

47. 537 F.2d 1255 (4th Cir. 1976).

48. Hardee, a long-time union member, wanted to attend the meeting because

and the meeting. When these attempts failed, he made arrangements to make part of the trip and to fly home in time for the meeting; his fellow driver agreed to drive the rest of the way back alone. He informed the Allied dispatchers of his plans. The controversy arose because he later falsified his log by claiming to have been in the sleeper cabin of the truck when in fact he had flown home for the meeting. Moreover, he presented a claim for the total mileage of the trip and was later paid in full for that mileage as well as for delay time to which he was not entitled. When Allstate's regional manager learned that Hardee had in fact not made all of the return trip, an investigation was conducted and Hardee was discharged for "falsification of his log and theft of company time."<sup>49</sup>

Hardee requested his union<sup>50</sup> to protest his discharge through the grievance and arbitration process provided by the collective bargaining agreement between Allstate and the union. After the three stages of the grievance procedure failed to produce a satisfactory result, the dispute was presented to an arbitrator. The arbitrator upheld the discharge.<sup>51</sup> The plaintiff then filed charges with the National Labor Relations Board against the union for failure to adequately represent him. Charges were also filed against the defendant for wrongful discharge. All of these charges were subsequently dismissed by the Board.<sup>52</sup>

Having failed in his attempts to get redress through arbitration and the National Labor Relations Board, Hardee brought an action in federal court seeking damages from Allstate for wrongful discharge and defamation.<sup>53</sup> The jury awarded Hardee \$20,000 in compensatory damages and \$50,000 in punitive damages,<sup>54</sup> and Allstate appealed.

The federal courts have jurisdiction over breach of labor contract suits under section 301 of the Labor Management Relations Act.<sup>55</sup> However, there is a strong federal policy favoring the private resolution of such disputes by a method agreed upon by the

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charges he had made against the union were going to be considered.

49. 537 F.2d at 1258.

50. Local 509 of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America.

51. Appendix of Appellant at 165.

52. *Id.* at 64.

53. Hardee sought damages from Allstate for defamation based on the notices of investigation and termination.

54. 537 F.2d at 1257.

55. 29 U.S.C. § 185 (1970).

parties, commonly grievance and arbitration.<sup>56</sup> In the now famous *Steelworkers Trilogy*,<sup>57</sup> Justice Douglas emphatically announced a very limited role for the courts in reviewing a decision by an arbitrator:

This plenary review by a court of the merits would make meaningless the provisions that the arbitrator's decision is final, for in reality it would almost never be final. . . . [T]he question of interpretation of the collective bargaining agreement is a question for the arbitrator. It is the arbitrator's construction which was bargained for; and so far as the arbitrator's decision concerns the construction of the contract, the courts have no business overruling him because their interpretation of the contract is different from his.<sup>58</sup>

Thus a decision of an arbitrator which is unfavorable to a party to a labor contract usually bars that party from bringing an action under section 301.

However, the arbitral bar did not automatically require that the jury verdict in *Hardee* be overturned. The courts have developed several exceptions<sup>59</sup> to the arbitral bar. The decision can be set aside, for example, where the arbitrator did not base his conclusions only on an interpretation and application of the collective bargaining agreement;<sup>60</sup> where the arbitrator did not have authority under the contract to decide the dispute;<sup>61</sup> where the award violated law<sup>62</sup> or public policy;<sup>63</sup> where the award was incomplete or ambiguous;<sup>64</sup> or where there was a procedural defect that denied a party fundamental fairness.<sup>65</sup> *Hardee* based his attempt to overcome the arbitral bar on a breach of the union's duty of fair representation in its handling of the grievance and arbitra-

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56. "Final adjustment by a method agreed upon by the parties is declared to be the desirable method for settlement of grievance disputes arising over the application or interpretation of an existing collective-bargaining agreement . . . ." 29 U.S.C. § 173(d) (1970).

57. *Steelworkers v. American Mfg. Co.*, 363 U.S. 564 (1960); *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

58. 363 U.S. 593, 599 (1960).

59. See generally R. GORMAN, *BASIC TEXT ON LABOR LAW* at 584-603 (1976).

60. *Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

61. *Electrical Workers Local 278 v. Jetero Corp.*, 496 F.2d 661 (5th Cir. 1974).

62. *UAW Local 985 v. W.M. Chace Co.*, 262 F. Supp. 114 (E.D. Mich. 1966).

63. *Black v. Cutter Laboratories*, 43 Cal. 2d 788, 278 P.2d 905 (1955), *cert. denied*, 351 U.S. 292 (1956).

64. *IAM v. Crown Cork & Seal Co.*, 300 F.2d 127 (3d Cir. 1962).

65. *UNITED STATES ARBITRATION ACT*, 9 U.S.C. § 10 (1970).

tion process.<sup>66</sup> This argument was based on the 1976 Supreme Court decision in *Hines v. Anchor Motor Freight*<sup>67</sup> wherein the Court expressly held that:

The union's breach of duty relieves the employee of an express or implied requirement that disputes be settled through contractual grievance procedures; if it seriously undermines the integrity of the arbitral process the union's breach also removes the bar of the finality provisions of the contract.<sup>68</sup>

Perhaps the most interesting aspect of *Hines* was that the employer could be liable for damages, even after the arbitrator's decision,<sup>69</sup> regardless of whether the employer had conspired with the union in breach of its duty. In other words, the employer could not rely on the finality of the arbitrator's decision. The case involved employees who were discharged for dishonesty. An arbitrator upheld the dismissal. Subsequently, the employee sued both his employer and the union in federal court. The district court granted the union's motion for summary judgment. The Sixth Circuit, finding that a genuine issue of material fact existed as to whether the defendant union had breached its duty of fair representation,<sup>70</sup> reversed the judgment as to the union but affirmed the judgment for the employer, since there was "[n]o evidence of misconduct on the part of the employer."<sup>71</sup> The Supreme Court disagreed, pointing out that the employer had originated the charges that had turned out to be false:

Under the rule announced by the Court of Appeals, unless the employer is implicated in the Union's malfeasance or has

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66. The duty to represent fairly all employees in the bargaining unit was first recognized in the railroad industry, *Steele v. Louisville & N.R.R.*, 323 U.S. 192 (1944) (construing Railway Labor Act) and later was expanded to include other industries. *Ford Motor Co. v. Huffman*, 345 U.S. 330, 337-38 (1953); *Syres v. Oil Workers Local 23*, 223 F.2d 739 (5th Cir.), *rev'd per curiam*, 350 U.S. 892 (1955). The Fourth Circuit described this duty imposed on the union in *Griffin v. UAW*, 469 F.2d 181 (4th Cir. 1972):

A union must conform its behavior to each of . . . three separate standards. First, it must treat all factions and segments of its membership without hostility or discrimination. Next, the broad discretion of the union in asserting the rights of its individual members must be exercised in complete good faith and honesty. Finally, the union must avoid arbitrary conduct. *Id.* at 183.

67. 424 U.S. 554 (1976).

68. *Id.* at 567.

69. Justice Stewart took issue with this in his concurring opinion. *Id.* at 572.

70. 506 F.2d 1153 (6th Cir. 1974). The charges of dishonesty were later shown to be false. The employees argued that with a minimum of effort the union could have discovered that they were false and that the failure to do so was a result of the union's bad faith.

71. *Id.* at 1157.

otherwise caused the arbitral process to err, petitioners would have no remedy against Anchor even though they are successful in proving the Union's bad faith, the falsity of the charges against them, and the breach of contract by Anchor by discharging without cause. This rule would apparently govern even in circumstances where it is shown that a union has manufactured the evidence and knows from the start that it is false; or even if, unbeknownst to the employer, the union has corrupted the arbitrator to the detriment of disfavored union members. As is the case where there has been a failure to exhaust, however, we cannot believe that Congress intended to foreclose the employee from his § 301 remedy otherwise available against the employer if the contractual processes have been seriously flawed by the union's breach of its duty to represent employees honestly and in good faith and without invidious discrimination or arbitrary conduct.<sup>72</sup>

Thus the court in *Hardee* had clear precedent for removing the arbitral bar if it found that the union had breached its duty of fair representation. Hardee's testimony that there was hostility between himself and the union leadership was largely uncontested. He had twice been elected president of the local union, and both times the International Union had imposed a trusteeship on the local.<sup>73</sup> Hardee had filed charges against certain union officials which were discussed at the meeting giving rise to the falsification of the log.<sup>74</sup> However, as the court pointed out, "the mere existence of bad feeling is not enough to obviate the finality of an arbitration award; Hardee must show that his grievance was handled improperly."<sup>75</sup> The conduct of the union must be "arbitrary, discriminatory, or in bad faith."<sup>76</sup>

The attempt to establish the required breach of duty seemed to be based on three factors.<sup>77</sup> The first was that the union failed to call as a witness, Ray, Hardee's fellow driver on the trip in question. Hardee wanted Ray to establish that he had done his full share of work on the trip and believed that he was entitled

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72. 424 U.S. at 570.

73. Appendix of Appellant at 31-33.

74. The charges were against certain union officials for "abuse of members by written or oral communications and denying union members the right to address themselves to Union business in meetings." Brief for Appellant at 9.

75. 537 F.2d 1255, 1258 (4th Cir. 1976).

76. *Vaca v. Sipes*, 386 U.S. 171, 190 (1967).

77. Brief for Appellant at 23.

to full pay, and that thus he was not guilty of "theft of company time," since "theft requires intent."<sup>78</sup> The penalty provided in the contract for falsification of the log alone was a reprimand. However, Ray had in fact driven 400 more miles than had Hardee.<sup>79</sup> Moreover, the testimony of Ray would have been damaging in another way. Hardee wanted to establish that Ray was entitled to receive almost all of the money that Hardee had received, and that as a result the theft was really from Ray and not from Alstate. But this still left twelve dollars unaccounted for, and "under the collective bargaining agreement, the magnitude of theft is irrelevant; '[t]heft or dishonesty of any kind' carries a penalty of dismissal."<sup>80</sup>

The second factor relied on by Hardee to establish a breach of the duty of fair representation was that he was not allowed to help select the arbitrator. He testified that he had been told he would be allowed to assist in the selection.<sup>81</sup> However, as the defendant pointed out, the list of arbitrators was submitted by the Federal Mediation and Conciliation Service,<sup>82</sup> and all of the names submitted should have met relatively high standards of competence.

The final factor relied on by Hardee was the union's failure to cross-examine some of the witnesses. Hardee particularly stressed that the dispatchers, who allegedly knew about his plans to leave the truck and fly home, should have been questioned closely. The court stressed, however, that there was nothing these witnesses could have said that would change the fact that Hardee had falsified the log and that twelve dollars more had been paid than was actually owed. Moreover, the union is allowed to use wide discretion in deciding how to handle a grievance.<sup>83</sup>

The court was heavily influenced by evidence which tended to show that Hardee's grievance "was fully and vigorously prosecuted by the union."<sup>84</sup> Despite the fact that an employee had no absolute right to have his grievance taken to arbitration,<sup>85</sup> the union had processed Hardee's grievance through three stages of

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78. Brief for Appellee at 13.

79. Brief for Appellant at 17.

80. 537 F.2d at 1259 n.2.

81. Appendix for Appellant at 40.

82. Brief for Appellant at 25.

83. *Ford Motor Co. v. Huffman*, 345 U.S. 330, 338 (1953).

84. 537 F.2d at 1259.

85. *Vaca v. Sipes*, 386 U.S. 171, 191 (1967).

grievance procedure as well as arbitration. Hardee was apparently satisfied at the conclusion of the hearing with the way the union had handled his case, because he had the opportunity to add to the testimony presented at the hearing but declined to do so.<sup>86</sup> In addition, after the hearing, he told the arbitrator that he had been fairly represented and told the union representative that he had made a fine presentation.<sup>87</sup>

Finding that there was "insufficient evidence to support an inference by the jury that the arbitration proceeding was tainted by union misconduct or neglect,"<sup>88</sup> the court was bound by the arbitrator's decision that the discharge was not improper. Since there was also no evidence to support a jury verdict that the plaintiff could recover for defamation, the court reversed the judgment of the district court.<sup>89</sup>

### III. BANKING LAW

In *Jolly v. Marion National Bank*,<sup>90</sup> the South Carolina Supreme Court interpreted a section of the National Bank Act without the aid of precedent. A shareholder of a national bank is granted the right to inspect a list of shareholders of that bank in section 62 of the National Bank Act:

The president and cashier of every national banking association shall cause to be kept at all times a full and correct list of the names and residences of all of the shareholders in the association, and the number of shares held by each, in the office where its business is transacted. Such list shall be subject to the inspection of all the shareholders and creditors of the association, and the officers authorized to assess taxes under State authority, during business hours of each day in which business may be legally transacted. A copy of such list, verified by the oath of such president or cashier, shall be transmitted to the Comptroller of the Currency within ten days of any demand therefor made by him.<sup>91</sup>

The issue involved in *Jolly* is whether a shareholder has an abso-

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86. Appendix for Appellant at 59. However, such comments have been considered as not binding. *Holodnak v. Avco Corp.*, 381 F. Supp. 191, 196 n.5 (D. Conn. 1974).

87. Appendix for Appellant at 78.

88. 537 F.2d at 1259.

89. *Id.* at 1260.

90. \_\_\_\_ S.C. \_\_\_\_, 231 S.E.2d 206 (1976).

91. 12 U.S.C. § 62 (1970).

lute right of inspection, or is limited to inspection for a "proper purpose" under section 62.

In general, a state court is bound by federal decisions when construing a federal statute.<sup>92</sup> However, there were no federal court decisions interpreting the issue raised under this section of the National Bank Act.<sup>93</sup> Nor were there any applicable South Carolina decisions. The courts of other states have considered the issue, but such decisions are not binding on the courts of South Carolina, although they are persuasive authority.<sup>94</sup>

The case arose when the plaintiff, a shareholder of the defendant bank, attempted to inspect the list of bank shareholders. The bank refused his request, evidently because the shareholder was chairman of the board of directors of a newly chartered bank in Marion which was in direct competition with the defendant.<sup>95</sup> The plaintiff sought a writ of mandamus<sup>96</sup> in the circuit court to order the defendant to allow such inspection. The lower court held that the plaintiff had an absolute right under the National Bank Act to inspect the shareholder list and that he was entitled to a writ of mandamus as a matter of right.<sup>97</sup> The defendant appealed to the South Carolina Supreme Court.

The supreme court reversed the decision of the lower court and remanded it for further consideration.<sup>98</sup> The court found that the proper interpretation of the statute was not a settled issue and there was no language in the statute indicating that the shareholders' motive is irrelevant. As a result,

[t]he present statute simply states the common law rule and, without express language to the contrary, there is no sound rea-

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92. *E.g.*, *Keenan v. Luther*, 138 S.C. 539, 137 S.E. 144 (1927).

93. This can be explained by the following excerpt:

A state court has jurisdiction to enforce such legal right as the stockholders of a national bank may have to inspect the books of the bank, the appropriate remedy being mandamus. This is by virtue of the provision of the National Banking Act that for the purposes of all actions against national banks at law or in equity, they shall be deemed citizens of the state in which they are located, and that in such cases the Federal Circuit and District Courts shall have jurisdiction only as in cases between individual citizens of the same state.

10 AM. JUR. 2d *Banks* § 68 (1963).

94. *E.g.*, *Shepherd v. U.S. Fidelity & Guar. Co.*, 233 S.C. 536, 106 S.E.2d 381 (1958).

95. Record at 11.

96. This writ is generally conceded to be the appropriate remedy in such a case, although it is not the exclusive remedy. 5 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2250 (rev. perm. ed. 1976).

97. Record at 135.

98. \_\_\_\_ S.C. at \_\_\_\_, 231 S.E.2d at 208.



son to support the conclusion that Congress intended to enlarge upon the common law requirement that a shareholder is limited to a legitimate purpose in seeking to inspect the list of shareholders.<sup>99</sup>

Moreover, the court found that the writ of mandamus, according to the "overwhelming weight of authority,"<sup>100</sup> is not a writ of right but is granted in the discretion of the court. Drawing from the analogous authority of decisions of state courts dealing with state statutes on the right of shareholders to inspect corporate books and records, the court found that even where a statute grants an absolute right of inspection, the majority view allows an improper motive to be used as a basis for denying a writ of mandamus.<sup>101</sup> Since "there is nothing in the statute or the right conferred to justify the conclusion that the discretionary power of the State Courts in granting the writ of mandamus was abridged,"<sup>102</sup> the court remanded to consider the application for the writ as a matter of the court's discretion.<sup>103</sup>

To fully understand the import of this decision, one must review the common law and statutory history of a shareholder's right to inspect.<sup>104</sup> At common law a shareholder had a right, upon showing of proper purpose, to inspect corporate books and records, including shareholder lists, at a reasonable time and place.<sup>105</sup> While a writ of mandamus was the appropriate remedy for enforcement in most cases, the writ was not considered to be a matter of right. The shareholder had to demonstrate a "specific interest at stake rendering the inspection necessary, or some beneficial purpose for which the examination [was] desired."<sup>106</sup>

In the latter part of the nineteenth century, many states passed statutes which gave the shareholder in absolute terms the right to inspect corporate books and records. This was probably a result of the misuse of the common law provisions by majority

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99. *Id.* at \_\_\_\_, 231 S.E.2d at 208.

100. *Id.* (quoting *Linton v. Gaillard*, 203 S.C. 19, 25 S.E.2d 896 (1943)).

101. 55 C.J.S. *Mandamus* § 223 (1948).

102. \_\_\_\_, S.C. at \_\_\_\_, 231 S.E.2d at 208.

103. *Id.*

104. See generally 5 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2213 (rev. perm. ed. 1976); 18 AM. JUR. 2d *Corporations* § 178 (1965).

105. *Tucson Gas & Elec. Co. v. Schantz*, 5 Ariz. App. 511, 428 P.2d 686 (1967); *Leisner v. Kent Investors, Inc.*, 62 Misc. 2d 132, 307 N.Y.S.2d 293 (1970).

106. 5 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2214 (rev. perm. ed. 1976).

shareholders to limit the rights of minority shareholders.<sup>107</sup> The state courts have taken two different views as to the effect of these statutes. One interpretation is that the right of a shareholder to inspect corporate books and records is absolute; his motive or purpose is immaterial; and the court has no discretion on an application for a writ of mandamus to enforce this right, but must issue the writ as a matter of right.<sup>108</sup> The other, probably the majority,<sup>109</sup> is that although the right itself is absolute, the court on application for a writ of mandamus to enforce that right should exercise its discretion and deny the writ if the shareholder is seeking inspection for an improper purpose.<sup>110</sup>

South Carolina was among the states to enact a statute giving the shareholder a seemingly unqualified right to inspect corporate books and records.<sup>111</sup> There seems to be only one case construing this statute, and its exact interpretation is unclear. In *Self v. Langley Mills*,<sup>112</sup> the shareholder sought to force the corporation, which had been organized under South Carolina law, to bring its records, which were kept in another state, into South Carolina so that the shareholder could inspect them. The court stated that "[w]here a statute gives to stockholders the right to examine corporate books, mandamus seems to be granted as a matter of right."<sup>113</sup> However, on a petition for rehearing, the court indicated that "the exercise of the right and its enforcement by the courts are of necessity subject to the rule of reason."<sup>114</sup> Since the discussion involved only the decision to force the corporation to bring its records into the state, the "rule of reason" could apply either only to the time and place for the inspection, or to the right of inspection itself.

The current trend has been to redraft statutes dealing with

107. Note, "Proper Purpose" for Inspection of Corporate Stock Ledger, 1970 DUKE L.J. 393, 393-95.

108. *Johnson v. Langdon*, 135 Cal. 624, 67 P. 1050 (1902); *Venner v. Chicago City Ry.*, 246 Ill. 170, 92 N.E. 643 (1910); *In re Steinway*, 159 N.Y. 250, 53 N.E. 1103 (1899).

109. 18 AM. JUR. 2d *Corporations* § 186 (1965).

110. *Hutson v. Brown*, 248 Ala. 215, 26 So. 2d 907 (1946); *Knox v. Coburn*, 117 Me. 409, 104 A. 789 (1918); *Wight v. Heublein*, 111 Md. 649, 75 A. 507 (1910); *Bernet v. Multonman Lumber and Box Co.*, 119 Ore. 44, 247 P. 155 (1926).

111. Civil Code of S.C. § 2855 (1912): "Books Opened to Inspection. The books of any corporation organized under this article shall be kept open to the inspection of any stockholder at all times."

112. 123 S.C. 179, 115 S.E. 754 (1922), *modified*, 123 S.C. 197, 115 S.E. 759 (1923).

113. *Id.* at 188, 115 S.E. at 757.

114. *Id.* at 197, 115 S.E. at 759.

the shareholder's right to inspect so as to make proper purpose a statutory requirement.<sup>115</sup> South Carolina has followed this trend.<sup>116</sup> In addition, a majority of courts today shift the burden of proof, so that instead of the plaintiff being forced to prove proper purpose, the defendant must show an improper purpose.<sup>117</sup> These changes have in large part eliminated the controversy that was inherent in the absolute language of earlier statutes. However, not all states have enacted statutes specifically requiring a proper purpose. Thus the controversy still exists in those states, and the controversy would seem to be applicable to any inspection statutes that are absolute in terms, such as section 62 of the National Bank Act.

The language of the banking act grants a shareholder the right to inspect the shareholder list in unqualified terms, similar to those used in state statutes granting an absolute right to inspect all corporate books and records. This does not necessarily imply that the logic used in interpreting those statutes applies to the interpretation of the banking act. The right granted by section 62 is applicable only to shareholder lists. Since no mention is made of other corporate records, it is generally held that the common law rule still applies to all records other than shareholder lists.<sup>118</sup> There is, unfortunately, no clear indication of the intent of Congress.<sup>119</sup> However, courts and commentators have uniformly stated that motive is irrelevant to the right of a shareholder to inspect the shareholder list of a national bank.<sup>120</sup> Those

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115. 5 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2215.1 (rev. perm. ed. 1976).

116. S.C. CODE ANN. § 33-11-260 (1976).

117. 5 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2253.1 (rev. perm. ed. 1976).

118. Wittnebel v. Loughman, 80 F.2d 222 (2d Cir.), *aff'g* 9 F. Supp. 465 (S.D.N.Y. 1935) and 11 F. Supp. 571 (S.D.N.Y. 1935), *cert. denied*, 297 U.S. 716 (1936); McNair v. Bunt, 68 F.2d 814 (5th Cir. 1934).

119. The defendant argued that the obvious purpose behind § 62 (then § 5210) was to protect shareholders, since at that time they were held personally liable for contracts and debts of the bank as well as for the extent of their stock holdings. Since double liability has been abolished, there is no longer any reason for allowing an absolute right of inspection. Brief for Respondent-Appellant at 507 (citing Guthrie v. Harkness, 199 U.S. 148, 156 (1905)). The plaintiff, however, pointed out that if indeed the statute has "outlived its usefulness, it is a matter for action by the Congress, not the courts." Brief for Petitioner-Respondent at 6.

120. *Most v. First Nat'l Bank of San Diego*, 246 Cal. App. 2d 425, 54 Cal. Rptr. 669 (1966); *Murray v. Walker*, 156 Ky. 536, 161 S.W. 512 (1913); *Hurley v. National Bank of Middletown*, 252 App. Div. 272, 299 N.Y.S. 241 (1937); *In re Murray*, 195 Misc. 629, 88 N.Y.S.2d 579 (Sur. Ct. 1949).

courts that have considered the question also hold that a writ of mandamus should issue as a matter of right, with no discretion left to the court.<sup>121</sup> This is the position taken by the lower court<sup>122</sup> in *Jolly* as well as by the dissenting opinion in the supreme court decision.<sup>123</sup> This view has been described as follows:

Thus stockholders of a national bank have a right to inspect the list of stockholders and the number of shares held by them as recorded on the books of the bank, and the motive for wishing to inspect the list is wholly immaterial. The only requisites to the right of examination are that the applicant be a bona fide stockholder and that the application be made during business hours.<sup>124</sup>

The supreme court chose not to follow this interpretation of section 62 of the National Bank Act. However, the position taken by the court is not altogether clear. One interpretation of the opinion in *Jolly* is that the banking act merely codified the common law and that neither the shareholder right to inspect nor the right to the remedy of a writ of mandamus is absolute. This interpretation is indicated by the court's assertion that the "present statute simply states the common law rule."<sup>125</sup> The appellant made a persuasive argument in support of this view:

Indeed because the belief was prevalent at the time national banks were chartered under Federal law that there was no common law of the United States in the sense of a national or customary law, Title 12, U.S.C. Section 62, may represent only the congressional conviction that it was necessary to codify the common law right of inspection in order to make that right available to national bank shareholders.<sup>126</sup>

Further, there is case authority for the view that statutes granting

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There is dictum indicating the possibility of a contrary result. "Doubtless the court has power to withhold an inspection for an illegitimate purpose, and may regulate the time when the inspection shall be made." *People ex rel. Lorge v. Consolidated Nat'l Bank*, 105 App. Div. 409, 412, 94 N.Y.S. 173, 175 (1905). See also *Most v. First Nat'l Bank of San Diego*, 246 Cal. App. 2d 425, 54 Cal. Rptr. 669 (1966).

121. *Most v. First Nat'l Bank of San Diego*, 246 Cal. App. 2d 425, 54 Cal. Rptr. 669 (1966); *Hurley v. National Bank of Middletown*, 252 App. Div. 272, 299 N.Y.S. 241 (1937).

122. Record at 135.

123. \_\_\_\_ S.C. \_\_\_\_, \_\_\_\_, 231 S.E.2d 206, 208 (1976) (Littlejohn, J., dissenting).

124. *Id.* at \_\_\_\_, 231 S.E.2d at 209 (Littlejohn, J., dissenting) (quoting 10 AM. JUR. 2d *Banks* § 68 (1963)).

125. \_\_\_\_ S.C. at \_\_\_\_, 231 S.E.2d at 208.

126. Brief for Respondent-Appellant at 3.

a seemingly unqualified right of inspection in fact only codified the common law provision for inspection.<sup>127</sup> This may, of course, accurately represent the congressional intent in passing 12 U.S.C. § 62. The problem with this interpretation is that the statute deals only with shareholder lists. Therefore, it is only logical to assume that Congress had some purpose in mind other than to codify the common law, and the above interpretation of the statute makes no allowance for this purpose. Also, it has generally been held that statutes granting a right of inspection, in whatever terms, enlarge and extend the common law right.<sup>128</sup>

The other possible interpretation of *Jolly* is that the South Carolina Supreme Court has adopted the position taken by a majority of state courts in interpreting state statutes granting an absolute right of inspection of corporate books and records, *i.e.*, that the right is absolute but the writ of mandamus is discretionary. This interpretation finds support in the following logic and holding of the court: "There is nothing in the statute or the right conferred to justify the conclusion that the discretionary power of the state courts in granting the writ of mandamus was abridged."<sup>129</sup>

If the latter interpretation is the correct one of the position taken by the court, it brings the decision more in line with prevailing theory on inspection statutes. However, it still neglects the distinct possibility that Congress had a specific purpose in limiting the scope of section 62 to shareholder lists.

The court was undoubtedly influenced by the equities of the situation presented. The plaintiff, as a major stockholder and officer in a competing local bank, had at least doubtful motives for wanting to inspect the shareholder list. While the plaintiff originally held 300 shares of stock of the defendant bank, he sold and transferred all but one share after the lower court decision.<sup>130</sup>

127. *Dines v. Harris*, 88 Colo. 22, 291 P. 1024 (1930); *Sawyers v. American Phenolic Corp.*, 404 Ill. 440, 89 N.E.2d 374 (1949).

128. 5 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2215.1 (rev. perm. ed. 1976); *Self v. Langley Mills*, 123 S.C. 179, 188, 115 S.E. 754, 757 (1922), *modified*, 123 S.C. 197, 115 S.E. 759 (1923).

129. \_\_\_\_ S.C. at \_\_\_\_, 231 S.E.2d at 208. There is also an indication that the court may have shifted the burden to the defendant to show improper purpose on the shareholder's part, which, in effect, would qualify the absolute terms of the statute. The indication of this comes from a quotation cited with approval to the effect that "an improper motive or purpose on the part of the petitioning stockholder is a *defense* which will induce the court to deny the writ." *Id.* (quoting 55 C.J.S. *Mandamus* § 223 (1948) (emphasis added)).

130. Amendment to Transcript of Record at 1.

Since the issue was one of first impression in South Carolina, and since there was no binding precedent, the court was free to interpret the statute in whatever way it deemed appropriate. There were many factors influencing the court to find that the plaintiff's motive was not irrelevant: the equities of the situation, the demise of the double liability standard, and the current trend towards making a proper purpose a requirement for inspection of corporate records. Thus the court disagreed with the prevailing interpretation of section 62.

*Molly B. Barry*